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FairIsaac®

By Electronic Delivery

Federal Trade Commission
Office of the Secretary
Room H-159 (Annex Z)
600 Pennsylvania Ave., N.W.
Washington, D.C. 20580

Re: FACT Act Scores Study

Ladies and Gentlemen:

This comment letter is submitted on behalf of Fair Isaac Corporation ("Fair Isaac") in response to the February 28, 2005 Federal Register notice ("Notice") and request for public comment by the Federal Trade Commission ("FTC"). The Notice requests comments to assist the FTC and the Board of Governors of the Federal Reserve System in conducting a study on the effects of credit scores and credit-based insurance scores on the availability and affordability of financial products. Fair Isaac appreciates the opportunity to comment on this important matter.

Fair Isaac is the preeminent, global provider of statistically based credit risk evaluation systems, commonly known as credit scoring systems. Fair Isaac helps thousands of companies, in over 60 countries, acquire customers more efficiently, increase customer value, reduce fraud and credit losses, lower operating expenses and make credit available to more consumers. Founded in 1956, Fair Isaac powers more than 180 billion decisions a year for the world's leading banks and credit card issuers, as well as insurers, retailers, telecommunications providers, healthcare organizations and public agencies. We also help millions of individuals manage their credit health through the www.myfico.com website. Visit Fair Isaac online at www.fairisaac.com.

In the following pages you will find responses to the questions posed in the Federal Register Notice. In addition to the answers provided, we have included specific examples of some of the consumer education that Fair Isaac has provided. Fair Isaac believes that continuous consumer education improves the accessibility of credit to consumers. As consumers understand how to build, improve and manage their credit, they will have better access to credit and better access to the products best suited to their needs.

A. Credit Scores and Credit

Q1. Specifically, how are credit scoring models developed? Who develops credit scoring models? What data and methodologies are used to develop credit scoring models? What factors are used in credit scoring models? Why are those factors used? What other factors have been considered for use in credit scoring models, but are not used? Why are those other factors not used? Are there benefits or disadvantages, either to creditors or consumers, from the use of particular factors by credit scoring models?

Fair Isaac develops credit scoring models empirically. That is, Fair Isaac uses statistical methods to analyze historical credit data to determine how that data is predictive of future credit performance.

Credit scoring models are based on credit information that is predictive of future credit performance. However, a credit scoring model can be based only on the types of information that are available to the model's developer. For instance, a consumer reporting agency ("CRA") risk scoring model will use credit information available in consumer reports, such as payment history, amounts owed on credit accounts, length of credit history and the types of credit used, to evaluate whether and to what extent that information is predictive of future credit risk.

In developing FICO® scoring models,[1] Fair Isaac uses only certain information that is available in consumer reports. More specifically, Fair Isaac uses only consumer report information that meets three requirements: (1) the information must be predictive of future credit performance; and (2) use of the information will not violate the Equal Credit Opportunity Act ("ECOA"), implementing Regulation B or other applicable federal or state law. Information will be used only if it meets these requirements. In addition, in developing FICO scoring models, Fair Isaac does not use personal identifying information.

Q2. How many different credit scoring models are in use today? What different types of general purpose or specialized credit scoring models are available? Who offers credit scores?

While many different types of credit scoring models are used in the market today, the most well known "non-custom" models are those Fair Isaac models that use consumer report information from nationwide CRAs. FICO scores, which include the Classic FICO Score and the NextGen FICO Score, rank-order consumers according to the likelihood that their credit obligations will be paid as expected. More specifically, FICO Scores are designed to predict the likelihood that within a 24-month period an individual will become 90 or more days delinquent on one or more credit accounts. The FICO scores currently available are:

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[1] All references in this comment letter to "FICO scores" refer to FICO scores that lenders may obtain from the three nationwide CRAs.

Classic FICO Scores

Equifax	BEACON®
TransUnion	FICO® Risk Score, Classic (formerly EMPIRICA)
Experian	Experian/Fair Isaac Risk Model

NextGen FICO Scores

Equifax	Pinnacle℠
TransUnion	FICO® Risk Score, NextGen (formerly PRECISION)
Experian	Experian/Fair Isaac Advanced Risk Score

Credit Risk Score for Underserved Market

Fair Isaac Credit Services, Inc. Expansion™ Score

The nationwide CRAs and other persons also develop credit scoring models and offer credit scores. In addition, Fair Isaac, other scoring companies, and analytic groups within Lenders, all develop custom credit scoring models for use by individual lenders and specific industries.

Q3. How are credit scores used? Who uses credit scores, and how widely are they used? How do they fit into the underwriting process for mortgages, auto loans, credit cards, and other credit products? For what purposes are credit scores used, other than the initial underwriting or pricing decision?

Lenders use credit scores for various credit-related decisions, including to provide "firm offers" of credit to prospective and existing customers in connection with prescreening, to make application decisions and to manage existing accounts. For example, lenders may use credit scores in connection with prescreening to determine the consumers to whom to send "firm offers" of credit, what credit products to offer and how often to prescreen. In addition, lenders may use credit scores to determine whether to approve or decline an application for credit and, for those applications that will be approved, to determine the interest rate and other terms. Lenders also may use credit scores in connection with existing account management to mange credit lines and to develop collection strategies.

Credit scores, however, only comprise one aspect of the information considered by lenders in connection with credit-related decisions. That is, a lender will consider other information that may be predictive of future credit performance, including information provided by the consumer. For example, in analyzing an application for an automobile loan, a lender may use a credit score, in conjunction with the loan-to-value ratio, the age of the automobile and the applicant's debt-to-income ratio, in determining whether to approve the applicant for the loan and also to determine the terms of that loan.

Q4. How has the use of credit scores changed over time? When were they first used for each type of financial product (credit cards, mortgages, auto loans, etc.)? How has their *use expanded to encompass different groups of borrowers (e.g., lower income borrowers, urban/rural borrowers, borrowers with poor credit histories, borrowers with non-traditional credit histories)? If the use of credit scores has expanded to encompass different groups of borrowers, how has this affected the price or availability of credit to those borrowers?*

Credit scores have been used by lenders for over forty years, within various credit industries including credit card, auto lending, and mortgage lending. FICO scores specifically have been used by lenders since 1989.

In addition, the Expansion Score, which was introduced in 2004 by Fair Isaac Credit Services, is used by lenders to extend credit to consumers with little or no traditional credit history. Specifically, the Expansion Score assists lenders in evaluating and extending credit to creditworthy individuals who have little or no credit history with the three nationwide CRAs.

Q5. Has the use of credit scores affected the price and availability of mortgages, auto loans, credit cards, or other credit products? If so, are there estimates of the type and size of such changes? Have some groups of consumers experienced cost reductions while others have experienced cost increases? Have some groups of consumers experienced greater access to credit while others have experienced reduced access?
Q6. Has the use of credit scores affected the amount of credit made available to consumers? Has it affected initial loan-to-value ratios at which auto loans or mortgages (first- or second-lien) are originated to different groups of borrowers? Has it affected credit limits on credit cards and home equity lines of credit for different groups of borrowers?
Q7. How has the use of credit scores affected the costs of underwriting and/or the time needed to underwrite?

The use of credit scoring has improved the consistency, objectivity and efficiency of lenders' credit decisions, allowing more lenders to offer credit products and price those products commensurate to the level of risk for the specific consumer. As a result, both consumers and lenders have benefited from the increased use of credit scoring in connection with credit-related decisions. Prior to the use of credit scores in the 1960s, lenders manually reviewed and oftentimes subjectively evaluated applications and accounts. This manual and judgmental process was both costly and could result in inconsistent and potentially discriminatory credit decisions. These processes, in turn, limited the availability and kept the price of credit at relatively high levels compared to today's standards.

Credit scoring allows consumers to gain more access to credit, at lower rates. The use of credit scoring lowers the cost of credit by reducing loan losses, reducing the cost of evaluating applications, reducing the cost of managing credit portfolios, lowering marketing costs, increasing market transparency through prescreening and cutting the cost of funding by facilitating securitization of retail credit portfolios. In addition, credit approval, not just on credit cards but on installment loans and mortgages, can be done more rapidly due to less manual review, less paperwork and fewer requests by lenders for additional information, while the lender is able to better manage and to strengthen its control over risk exposure. These cost and time savings are passed on to the consumer in a competitive marketplace.

Credit scoring also has increased the availability of credit to consumers because it allows lenders to better assess credit risk for and tailor credit to each consumer's needs. The credit risk of an individual consumer may be assessed and accounted for, whether or not the lender has a preexisting relationship with the consumer, in a less intrusive manner than a subjective evaluation process. A lender that uses credit scoring as part of its decisioning process can extend credit to more consumers without increasing its credit risk.

Case studies conducted by Fair Isaac demonstrate that credit scoring can make credit available to more consumers and maintain the safety and soundness of the credit issuer. For example, the results of one case study, conducted for a credit card issuer that was judgmentally evaluating applicants, concluded that if credit scoring had been used in the decisioning process, the issuer would have been able to either double its approval rate without increasing its credit risk, or reduce its credit risk by half without decreasing its approval rate.

This study found that the credit card issuer's original decisioning process, which did not include the use of credit scoring, resulted in a 36% acceptance rate and a 10.5% bad debt rate. If the lender had used FICO scores as part of its decisioning process and established a cutoff FICO score of 680, the lender could have achieved a 39% acceptance rate but a much lower bad debt rate of 4.8% for this portfolio. Selecting a cutoff FICO score of 620 could have potentially resulted in a similar 10.3% bad debt rate, but doubled the acceptance rate. The following chart(s) illustrate(s) the performance results that this credit card issuer could have achieved if it had incorporated credit scoring into its decisioning process.

CRA Risk Score	Overall Acceptance Rate	Overall Bad Debt Rate
550	91%	15.9%
600	82%	13.8%
620	73%	10.3%
640	62%	8.8%
660	48%	6.6%
680	39%	4.8%
700	26%	3.3%
720	18%	2.1%

In this case study, the lender has the option of approving a much higher percentage of applications thus providing credit to more consumers; reducing bad debt rates which in turn reduces the cost of credit and allows credit at lower rates; or some combination of these two benefits.

Q8. What impact has the use of credit scores had on the accuracy of underwriting decisions? What impact has the use of credit scores had on the share of applicants that are approved for mortgages, auto loans, credit cards, or other credit products? What impact has the use of credit scores had on the default rates of mortgages, auto loans, credit cards, or other credit products? Have the sizes of such changes or effects been estimated and reported?

Credit scoring models utilize consumer report information to assess the factors that statistically are most predictive of future credit performance. Factors that do not have predictive value and factors that by law cannot be used in the credit decisioning process are excluded from consideration. The resulting credit scores for a given scoring model are more consistent from consumer to consumer because they assess the same factors the same way. Credit scoring ensures that consumer report information will be objectively evaluated in accordance with accepted statistical principles, and therefore the results are fairer to all consumers. That is, credit scoring assures that consumers will be evaluated empirically and objectively according to the same criteria.

The case study in response to question 7 above is an example where the credit score can be used to make credit available to twice as many applicants without an increase in bad debt rate; or to provide credit to the same number of applicants at improved interest rates due to decreased bad debt rates.

Q9. Has the use of credit scores affected the cost and availability of credit to consumers with poor credit histories? If so, how? What effect has it had on the use of credit by consumers with poor credit histories?

Before the use of credit scores became common, lenders used so-called "rule-based" systems to make credit-related decisions. Under a lender's rule-based system, for example, <u>any</u> applicant who had a previous 90+-day delinquency in his or her credit history might not be approved. With the advent of credit scoring, specific credit information can be evaluated in relationship to other credit information and weighted according to their empirical relationship to predict future credit performance. As a result, unlike a rule-based system, all consumers with a previous 90+-day delinquency in their credit history do not need to be declined, and some of those consumers can be approved.

Credit scoring systems operate so that certain positive factors can compensate for the presence of, for example, a prior 90+-day delinquency, and individuals with those factors should score higher than others who do not have those positive factors. The end result for lenders is that they better understand and can more accurately predict the risk of consumers with past credit problems. Moreover, lenders have been more able and willing to extend credit to these consumers. For consumers with past credit problems that also have positive factors, the result has been greater access to credit at better rates.

Q10. How has the use of credit scores affected the cost and availability of credit to consumers with no credit history? What effect has it had on the use of credit by consumers with no credit history?

As noted above, before the advent of credit scoring, the credit-decisioning process was often time-consuming, requiring that lenders gather and manually review extensive documentation for all applicants. With the increased use of credit scoring, the credit decisioning process has become more streamlined for many applicants with credit histories.

While credit scoring has increased efficiencies and reduced lenders' expenses and made borrowing more affordable for the vast majority of consumers, these benefits may not be directly realized by consumers with little or no credit histories. Sensing the need for tools to extend similar benefits to this "underserved" segment of the population, Fair Isaac Credit Services, Inc. introduced the Expansion™ Score in 2004. As noted above, the Expansion Score assists lenders in evaluating and extending credit to creditworthy individuals who have little or no credit history with the three nationwide CRAs.

Q11. How has the use of credit scores affected refinancing behavior for mortgage, auto, or student loans? How has it affected the average life of revolving lines of credit (including credit cards)?

As with first liens, credit scoring has made refinancing more affordable and accessible to consumers. Credit scoring, along with other relevant information, assists lenders in assessing the appropriate risk and providing the consumer with a rate commensurate with the risk assessment, in a more timely manner.

Q12. Has the use of credit scores and credit scoring models impacted the availability or cost of credit to consumers by geography, income, ethnicity, race, color, religion, national origin, age, sex, marital status, or creed? If so, how has it impacted each such category? What are the estimated sizes of any such changes for each of the above categories?

As noted above, credit scoring has increased the availability of credit to consumers generally. This expanded availability is not unique to any specific "category" of consumers. See the answers to questions 13-15.

Q13. To what extent does consideration or lack of consideration of certain factors by credit scoring systems result in negative or differential treatment of those categories of consumers who are protected under the ECOA (e.g., race, color, religion, national origin, sex, age, and marital status)?

Consumers who are protected under the ECOA have benefited from credit scoring because credit scoring promotes unbiased lending decisions. For example, FICO scores do not analyze or include any ECOA protected characteristics, such as gender, marital status or race. As a result, FICO scores are "blind" to these prohibited factors. Moreover, as credit scoring has increasingly become one of the factors used in the credit decisioning process, FICO scores have helped to remove any bias that a judgmental lending system may have included. As discussed in further detail in response to questions 14 and 15, studies have concluded that consumers with the same FICO score pose the same level of risk of default or credit risk, regardless of the income level of the consumer or whether the consumer resides in an area with a high percentage of minority residents.

Q14. To what extent, if any, could the use of underwriting systems that rely on scoring models achieve comparable results through the use of factors with less negative impact on those categories of consumers who are protected under the ECOA?
Q15. What steps, if any, do score developers, lenders, or other users of credit scores take to ensure that the use of credit scores does not result in negative or differential treatment of protected categories of consumers under the ECOA? Have score developers, lenders, or other users of credit scores changed the way credit scores are developed or used in order to avoid negative or differential treatment of protected categories of consumers under the ECOA? Are any particular credit history factors not used because of actual or potential negative or differential treatment of protected categories of consumers under the ECOA? If so, what are they?

Two studies conducted by Fair Isaac in 1996 support the view that credit scoring systems assess credit risk consistently, regardless of race, national origin or income.

The first study ("LMI study") used data from more than 20 credit portfolios to look at score distributions and differences in characteristics between low-to-moderate income ("LMI") applicants and the general population. This study also compared the acceptance and default rates for LMI segments, resulting from actual judgmental underwriting experience on eight of these portfolios, with the results that could have been obtained using credit scoring to evaluate these same applicants.

The second study ("HMA study") compared credit scores and characteristics of consumers living in zip codes with higher concentrations of minorities ("HMA zip codes") with those of consumers living in other zip codes. Zip code was used as a surrogate for race/national origin because race/national origin information on individuals was not available. The average household income in HMA zip codes, as indicated by census data, was about two-thirds that for the non-HMA zip codes. As a result, the HMA (High Minority Area) population in many ways resembles the LMI population in the first study.

These studies showed that scoring is both fair and effective when applied to LMI/HMA populations, and that scoring produces substantial improvements in the quality of decisions when compared with judgmental underwriting.

The above two studies demonstrate that, for any given score range, the subsequent loan performance proved the risk assessment of the score was accurate and appropriate for both the general population and the LMI/HMA populations studied. The score-to-odds relationships (i.e., the number of consumers that will pay compared to the number that will not at any given score band,) of the LMI/HMA populations compared to the general population were virtually identical (especially in the range where most cut-off scores would be set). To the extent there were any differences in the score-to-odds relationships; those differences consistently favored the LMI/HMA applicants. That is, at any given score the risk of credit loss for LMI/HMA applicants was the same as or slightly greater than the risk for applicants from the general population receiving the same score.[2]

The LMI study also demonstrated that the judgmental decisions on LMI applicants in most of the portfolios studied ranged from poor to bad based on observed subsequent performance. When actual acceptance and delinquency rates for LMI borrowers underwritten with judgmental systems were compared with the results that could have been obtained had credit scoring been used to evaluate the same applicants, credit scoring would have produced a significant increase in the acceptance rate for LMI applicants if the bad debt rate were held constant, or a significant decrease in the bad debt rate if the acceptance rate were held constant. In other words, when scoring systems replace judgmental decisions, more applications from this population group are approved without increasing the risk to the lender.

In short, these studies indicate that scoring is both fair and effective when applied to low to moderate income and minority populations, and that scoring can produce substantial improvements in the quality of decisions when compared with judgmental underwriting.

Q16. Has the use of credit scores caused a change in the rate of home ownership? What is the estimated size of such a change?

Since the early 1980s, the percentage of families who own their own homes has increased dramatically from 60% to 69%. Moreover, the rate of home ownership has increased most dramatically for minority populations. A 2003 study conducted by the Information Policy Institute indicates that home ownership for minority populations increased from 34% to 47% between 1983 and 2001. This increase in the rate of home ownership for minority populations represents an increase of 38 percentage points,

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[2] This difference in risk for the same numeric score is due to the model having been developed using the general population and the study having been conducted on only an isolated segment of that population

compared to an increase of 13 percentage points (from 60-68%) for the overall population.

The use of credit scoring in mortgage underwriting has likely played an important role in the increased rate of home ownership. As noted above, credit scoring allows lenders to better assess credit risk, while other factors, such as the development of a variety of mortgage loan products, also has helped expand home ownership. By incorporating credit scoring as part of their decisioning processes, mortgage lenders have been able to provide mortgage loans to more consumers without increasing their credit risk.

Q17. Has the use of credit scores caused a change in the method and amount of pre-screening consumers for credit offers? What effects has this had on the terms offered to consumers?

As noted above, lenders use credit scores in connection with prescreening to determine the consumers to whom to send "firm offers" of credit, what credit products to include in these offers and how often to prescreen.

Because credit scoring allows lenders to better assess credit risk and tailor credit products to meet the needs of consumers, lenders can conduct prescreening in a more efficient manner when credit scoring is incorporated in the prescreening process. More specifically, credit scoring allows lenders to send offers to those consumers who are preapproved for credit and to those consumers that may be most interested in certain credit products.

Q18. What specific role do credit scores play in granting "instant credit?" What impact have credit scores had on the availability and use of instant credit?

Credit scores facilitated "instant credit" among retail lenders in the early 1990's. Decisions based on credit scores can be delivered in real-time and allow lenders to make faster and more accurate decisions than under a judgmental decisioning process. For example, using credit scores as part of the decisioning process allows a lender to identify the risk and grant credit lines appropriate for a specific consumer without gathering and manually reviewing extensive documentation. Without credit scoring, the process of gathering and manually reviewing extensive data alone likely would eliminate "instant credit," as we know it today. Moreover, if credit scores were not used, the risk of granting instant credit would be higher.

Q19. How has the use of credit scores affected companies' ability to enter new lines of business or expand activities in the various credit industries?

FICO scores help lenders move into new geographic areas or offer new products with the comfort of having a statistical tool to initially estimate performance. For instance, if a lender develops a new product, generally they would estimate the performance (future losses) based on industry knowledge. With FICO scores, a lender can obtain a validation chart for that particular product and estimate with more confidence based on a statistical relationship for that product with other lenders. As a result, the lender would be able to offer potentially better rates for that product because of the increased confidence in performance estimates.

Q21. How are credit scores used to manage existing credit accounts, such as credit card accounts? How has the use of credit scores affected the way credit accounts are managed? How are credit scores used in the servicing of mortgages, and how has the use of credit scores affected the way mortgages are serviced?

Credit scores provide a snapshot of credit risk at a particular point in time. These scores can change over time as credit information changes or becomes available. As a result, credit scores provide many lenders an important tool to monitor and evaluate the credit risk of specific accounts, and their debt portfolios more generally, on an ongoing or periodic basis. For example, a credit card issuer can use credit scores to adjust credit limits on its accounts according to changes in the underlying credit risk of its cardholders. In addition, as noted above, lenders also use credit scores in connection with existing account management to develop collection strategies and for authorization purposes.

Q22. How are records of inquiries used by credit scoring systems? Does concern about the possible effects on their credit scores affect consumers' credit shopping behavior? If so, what impact does this have on the consumers or on competition in the various credit markets?

Fair Isaac will include inquiries, or instances when a lender or other person has requested that a CRA provide a consumer report for certain purposes, in its FICO scoring models only if those inquiries are predictive of future credit performance. However, FICO scoring models do not consider certain inquiries and requests for consumer reports. For example, FICO scores only consider inquiries from the prior 12 months. In addition, FICO scores do not count certain requests for consumer reports, including: (1) prescreening requests; (2) account review requests; (3) consumer disclosure requests; (4) insurance requests; and (5) employment requests. Moreover, FICO scores limit any possible negative impact of inquiries related to consumer shopping by: (1) excluding any mortgage or automobile installment loan inquiries that have occurred within the 30 days before the score is generated; and (2) grouping together mortgage or automobile installment loan inquiries as 1 inquiry if these inquiries occurred within a short period of time.

Inquiries and new credit account openings constitute approximately 10% of the factors analyzed in the FICO scoring system.

23. How does the use of credit scores affect consumers with inaccurate information on their credit reports? How does the use of credit scores affect consumers who have been the victims of identity theft?

Credit bureau risk scores are calculated based on the data available in a consumer's credit report. Credit scores can help consumer spotlight inaccurate information by focusing their attention toward what's driving a low score. Similarly, credit score monitoring provides a convenient way for a consumer, including victims of ID Theft, to monitor their credit standing over time in the future, after any file alerts have been lifted.

A consumer has the option to submit a dispute in circumstances where they feel their information is inaccurate. And if the results of the investigation of the dispute are not resolved in the consumers favor, under FACTA, the consumer can request a statement with their version of the facts to be appended to the file.

Adverse action notices, with up to four primary reasons, are provided to all lenders when they obtain FICO scores for underwriting or account management, and the FCRA requires that the lender share this information with consumers if adverse action is taken based on the score. The consumer can request the credit report offered by the adverse action notice and can verify the accuracy of the data.

Any consumers who are victims of identity theft should immediately contact the credit reporting agencies and should request a fraud alert be placed on their credit report. With that fraud alert in place, a lender will work directly with the applicant to positively identify the consumer as well as identify the data in the credit report that belongs to that consumer.

B. CREDIT-BASED INSURANCE SCORES AND PROPERTY AND CASUALTY INSURANCE

Q1. Specifically, how are credit-based insurance scoring models developed? Who develops credit-based insurance scoring models? What data and methodologies are used to develop credit-based insurance scoring models? What factors are used in credit based insurance scoring models? Why are those factors used? What other factors have been considered for use in credit-based insurance scoring models, but are not used? Why are those other factors not used? Are there benefits or disadvantages, either to insurers or consumers, from the use of particular factors by credit-based insurance scoring models?

Fair Isaac develops credit-based insurance scoring models empirically. That is, Fair Isaac uses statistical methods to analyze historical credit data to determine how predictive that data is of future insurance loss risk.

Credit-based insurance scoring models are based on credit information that is predictive of future insurance loss risk. However, a credit-based insurance scoring model will be limited to the types of information that are available to the model's developer. Generally, credit-based insurance scoring models are based on credit information available in consumer reports that is predictive of future insurance loss ratio.

Fair Isaac uses the following method to develop credit-based insurance scores. Performance data (claims and premium data on insurance policies) is gathered and pooled together from insurers. Fair Isaac then uses this data to generate a common measure of insurance risk for each insurance account.[3] Generating a common measure of risk allows Fair Isaac to compare the relative performance of individual accounts. Fair Isaac then uses statistical methods to evaluate archived consumer report information for these accounts to identify which information is predictive of insurance loss risk. Any consumer report information that is predictive of future insurance risk may be used in creating the credit-based insurance scoring model, subject to certain limitations discussed below.

In developing credit-based insurance scoring models, Fair Isaac only uses consumer report information that meets three requirements: (1) the information must have a statistical relationship to future insurance loss ratio relativity; (2) use of the information will not violate applicable federal or state law. Information will be used only if it meets these requirements. In addition, in developing credit-based insurance scoring models, Fair Isaac does not use personal identifying information, sometimes referred to as credit "header" data.

Q2. How many different credit-based insurance scoring models are in use today? Who offers credit-based insurance scores?

[3] The metric used in the development of Fair Isaac credit-based insurance scores is loss ratio relativity: the loss ratio (losses divided by premiums earned) for an individual account compared to that of the population as a whole.

Fair Isaac offers credit-based insurance scores through each of the nationwide CRAs. Currently over 350 insurers utilize Fair Isaac credit-based insurance scores in their underwriting or renewal processes. The Fair Isaac credit-based insurance scores currently available are:

Equifax	InScore®
Experian	Experian/Fair Isaac Insurance Score
TransUnion	Fair Isaac® Insurance Risk Score (formerly ASSIST)

Q3. How are credit-based insurance scores used? Who uses credit-based insurance scores, and how widely are they used? How do they fit into the underwriting and rating process for automobile and homeowners insurance?

Credit-based insurance scores are used by insurers to augment insurance underwriting to determine likely future loss potential and to assess an appropriate premium. For example, in both personal automobile and homeowner's insurance, many insurers use credit-based insurance scores for underwriting selection and tiering (assignment of individual risks into particular insurance programs). These scores, however, only comprise one aspect of the information considered by insurers. For example, insurers also may consider other information, including claims history, location and type of home or automobile, age, marital status and driving record.

Generally, when an insurer begins using credit-based insurance scores, they append credit-based insurance scores retroactively onto their book of business to compare the rank-ordering of actual loss ratios with the scores. The insurer looks for the correlation of lower scores with higher loss ratios and higher scores with lower loss ratios. When such correlations are confirmed and found to be significant, the insurer then selects a cutoff score value to reject and accept risks and/or score ranges for assignment of risks into various insurance programs. Some insurers provide premium rate discounts based on score values as part of their rating procedures.

Q4. Has the use of credit-based insurance scores affected the price and availability of automobile and homeowners insurance? We are especially interested in evidence containing estimates of the size of such changes. Have some groups of consumers experienced cost reductions while others have experienced cost increases? If so, which consumers have experienced reductions and which have experienced increases, and what are the magnitudes of those changes? Have some consumers experienced dramatic increases in their insurance premiums, solely as the result of the introduction of credit-based insurance scoring? If so, what has been the impact of this rise in premiums on these consumers?

Insurers have stated that 60-75% of their policyholders pay lower premiums because of credit-based insurance scoring. In addition, it has been reported that if credit information was prohibited from being used in insurance underwriting, the majority of

policyholders would see rate increases, and some policyholders would see rate increases of as much as 20 percent.
http://www.washtimes.com/business/20030612-112141-5259r.htm

Q5. How has the use of credit-based insurance scores affected the costs of underwriting and rating and/or the time needed to underwrite and rate?

Credit-based insurance scores allow insurers to accelerate their processing for applicants and renewal for policyholders, to spend additional underwriting time on higher-risk individuals and to better manage operational strategies.

Q10. How has the use of credit-based insurance scores impacted the availability or cost of insurance to consumers by geography, income, ethnicity, race, color, religion, national origin, age, sex, marital status, or creed? What are the estimated sizes of such changes for each of the above categories?
Q11. To what extent does consideration or lack of consideration of certain factors by credit-based insurance scoring systems result in negative or differential treatment of protected classes of consumers, that is, the same categories of consumers against whom discrimination is prohibited under the ECOA (e.g. race, color, religion, national origin, sex, age, and marital status)?
Q12. To what extent, if any, could the use of underwriting systems relying on credit-based insurance scoring models achieve comparable results through the use of factors with less negative impact on consumers in the ECOA protected categories?
Q13. What steps, if any, do score developers or insurance companies take to ensure that the use of credit-based insurance scores does not result in negative or differential treatment of protected categories of consumers listed in the ECOA? Have score developers or insurance companies changed the way credit-based insurance scores are developed or used in order to avoid negative or differential treatment of protected categories of consumers listed in the ECOA? Are any particular credit history factors not used because of actual or potential negative or differential treatment of protected categories of consumers listed in the ECOA? If so, what are they?

Credit-based insurance scoring has helped consumers in the ECOA protected categories. Fair Isaac credit-based insurance scoring models do not consider factors, such as gender, age, race and marital status, and other categories listed under the ECOA and, as a result, they are "blind" to these factors. Fair Isaac credit-based insurance scores have no bias and therefore, as credit-based insurance scoring has increasingly become one of the factors used in underwriting and renewal decisions, it has helped to remove bias that a judgmental system may have.

Without credit-based insurance scoring's powerful ability to differentiate consumers based on their likely future insurance risk, insurers would not be able to as efficiently set premiums based on an individuals' risk of insurances loss, and so they would charge the majority of customers (most of which are low risk) more to compensate for the minority of their customers that result in larger losses.

Q14. Has the use of credit-based insurance scores caused a change in the method and amount of pre-screening consumers for insurance offers? What effects has this had on the terms offered to consumers?

Credit-based insurance scores provide effective risk segmentation, in addition to other prescreening variables, to allow insurers to offer automobile and home insurance policies with more confidence at more appropriate pricing levels given segmented loss expectancies. More consumers receive offers of insurance, based on credit-based insurance scores than would receive offers based solely on other risk variables.

Q15. How has the use of credit-based insurance scores affected companies' ability to enter new lines of the automobile or homeowner's insurance business?

More effective risk segmentation allows insurers to confidently offer a wider scope of coverage (e.g., non-standard auto policies) with appropriate variation in pricing levels.

Q18. What impact, if any, does banning or limiting the use of particular underwriting or rating factors, such as gender, territory, or credit-based insurance score, have on the price or availability of automobile or homeowners insurance? Has the prohibition on the use of credit-based scores for insurance in particular states had any impact on the price or availability of automobile or homeowners insurance for consumers in those states? If so, what has that impact been? If the use of credit-based insurance scores was not allowed in additional states, what impact would this have on the price or availability of automobile or homeowners insurance? Are there, or would there be, any specific effects on those insurance consumers who are within protected categories listed in the ECOA?

The removal of any factor that effectively and accurately segments applicants and policyholders based on future insurance loss risk weakens the ability of an insurer to properly price policies based on risk. The majority of consumers manage their credit responsibly and, whether within protected or non-protected groups, would lose the benefit of premium discounting based in part on credit-based insurance scores.
When the State of Maryland banned the use of credit and credit-based insurance scores for homeowner underwriting and pricing, insurers were unable to most effectively segment presented risks and were forced to seek higher premiums from the majority of Maryland homeowner policyholders who had previously benefited from their insurer's use of credit-based insurance scores. Most homeowners saw premium increases of more than 20% and some as high as 40%. Similar bans in other states would result in similar actions – the majority of consumers manage their credit responsibly and, whether within protected or non-protected groups, would lose the benefit of premium discounting based in part on credit-based insurance scores.

Q19. How are records of inquiries used by credit-based insurance scoring systems? Does concern about the possible effects on their credit-based insurance scores affect *consumers' insurance-shopping behavior? If so, what impact does this have on competition in the insurance markets?*

Fair Isaac will include inquiries in its credit-based insurance scoring models only if those inquiries are predictive of future insurance loss. However, these models do not consider certain inquiries and requests for consumer reports. For example, Fair Isaac credit-based insurance scores only consider inquiries from the prior 12 months. In addition, Fair Isaac credit-based insurance scores do not count certain requests for consumer reports, including: (1) prescreening requests; (2) account review requests; (3) consumer disclosure requests; (4) insurance requests; (5) employment requests; (6) medical requests; and (7) collection requests. Moreover, Fair Isaac credit-based insurance scores limit any possible negative impact of inquiries related to consumer shopping by: (1) excluding any mortgage or automobile installment loan inquiries that have occurred within the 30 days before the score is generated; and (2) grouping together mortgage or automobile installment loan inquiries as 1 inquiry if these inquiries occurred within a short period of time (generally 30 days). In addition, some states prohibit or limit the use of inquiries in insurance score models. In these states, the Fair Isaac models are adjusted accordingly.

Inquiries and new credit account openings constitute approximately 10% of the factors analyzed in the Fair Isaac credit-based insurance scoring models.

C. Consumer Credit Scoring Education Activities

Fair Isaac strives to educate consumers about credit scoring. Fair Isaac believes that education empowers consumers to better manage their credit, to understand how credit scores affect their ability to obtain credit and also to obtain credit at the best rates possible.

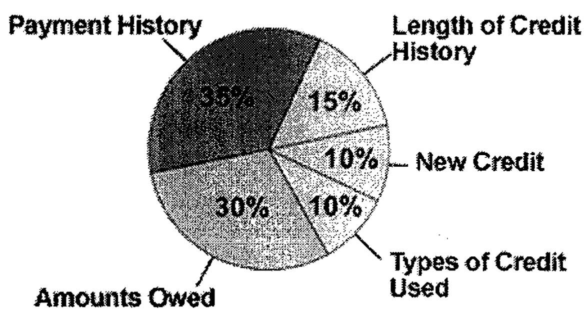
Consumer Credit Scoring Education. As the use of credit scoring has grown, Fair Isaac has provided consumers with educational information to help consumers understand credit scoring and to use this knowledge to take control of their credit. For example, since the early 1990s, Fair Isaac has published consumer booklets on credit scoring, including booklets published in conjunction with the FTC, Freddie Mac and the Consumer Federation of America. Fair Isaac also has provided credit scoring information on the Internet at www.myFICO.com ("myFICO.com"). For example, a consumer interested in learning more about his or her FICO score can access myFICO.com to obtain a FICO Score, an explanation of the score and the underlying consumer report.

Fair Isaac is committed to its consumer education initiatives that are designed to promote financial literacy for consumers. Millions of consumers have obtained information about credit scoring by reviewing information published and made available by Fair Isaac. Fair Isaac is committed to providing information that will equip consumers with accurate, actionable information, while avoiding the confusion that can arise due to the complexity of this topic. Fair Isaac provides consumers with significant information concerning credit scoring at no charge and also offers consumer-specific information for a fee.

Fair Isaac Provides Considerable Educational Information to Consumers. As noted above, Fair Isaac provides consumers with free educational information on credit scoring directly from myFICO.com and also in booklet form.[4] For example, myFICO.com provides a general weighting of the consumer report factors evaluated by FICO scoring models so that consumers know what events or behaviors have the greatest impact on FICO scores in general. The following is an example of the free information available at myFICO.com[5]:

What's in Your Score Email This

FICO Scores are calculated from a lot of different credit data in your credit report. This data can be grouped into five categories as outlined below. The percentages in the chart reflect how important each of the categories is in determining your score.



These percentages are based on the importance of the five categories for the general population. For particular groups - for example, people who have not been using credit long - the importance of these categories may be somewhat different.

Payment History

- Account payment information on specific types of accounts (credit cards, retail accounts, installment loans, finance company accounts, mortgage, etc.)
- Presence of adverse public records (bankruptcy, judgements, suits, liens, wage attachments, etc.), collection items, and/or delinquency (past due items)
- Severity of delinquency (how long past due)
- Amount past due on delinquent accounts or collection items
- Time since (recency of) past due items (delinquency), adverse public records (if any), or collection items (if any)

[4] Available at http://www.myfico.com/Offers/RequestOffer.asp.
[5] Available at http://www.myfico.com/myfico/CreditCentral/ScoreConsiders.asp

- Number of past due items on file
- Number of accounts paid as agreed

Amounts Owed

- Amount owing on accounts
- Amount owing on specific types of accounts
- Lack of a specific type of balance, in some cases
- Number of accounts with balances
- Proportion of credit lines used (proportion of balances to total credit limits on certain types of revolving accounts)
- Proportion of installment loan amounts still owing (proportion of balance to original loan amount on certain types of installment loans)

Length of Credit History

- Time since accounts opened
- Time since accounts opened, by specific type of account
- Time since account activity

New Credit

- Number of recently opened accounts, and proportion of accounts that are recently opened, by type of account
- Number of recent credit inquiries
- Time since recent account opening(s), by type of account
- Time since credit inquiry(s)
- Re-establishment of positive credit history following past payment problems

Types of Credit Used

- Number of (presence, prevalence, and recent information on) various types of accounts (credit cards, retail accounts, installment loans, mortgage, consumer finance accounts, etc.)

Please note that:

- **A score takes into consideration all these categories of information, not just one or two.** No one piece of information or factor alone will determine your score.
- **The importance of any factor depends on the overall information in your credit report.** For some people, a given factor may be more important than for someone else with a different credit history. In addition, as the information in your credit report changes, so does the importance of any factor in determining your score. Thus, it's impossible to say exactly how important any single factor is in determining your score - even the levels of importance shown here are for the general population, and will be different for different credit profiles. What's important is the mix of information, which varies from person to person, and for any one person over time.
- **Your FICO score only looks at information in your credit report.** However, lenders look at many things when making a credit decision including your income, how long you have worked at your present job and the kind of credit you are requesting.
- **Your score considers both positive and negative information in your credit report.**

Late payments will lower your score, but establishing or re-establishing a good track record of making payments on time will raise your score.

MyFICO.com also provides consumers with examples of the types of information that are not included in FICO scoring models.[6]

What's Not in Your Score Email This

FICO scores consider a wide range of information on your credit report. However, they do not consider:

- **Your race, color, religion, national origin, sex and marital status.**
  US law prohibits credit scoring from considering these facts, as well as any receipt of public assistance, or the exercise of any consumer right under the Consumer Credit Protection Act.

- **Your age.**
  Other types of scores may consider your age, but FICO scores don't.

- **Your salary, occupation, title, employer, date employed or employment history.**
  Lenders may consider this information, however, as may other types of scores.

- **Where you live.**

- **Any interest rate being charged on a particular credit card or other account.**

- **Any items reported as child/family support obligations or rental agreements.**

- **Certain types of inquiries (requests for your credit report).**
  The score does not count "consumer-disclosure" inquiries - requests you have made for your credit report, in order to check it. It also does not count "promotional inquiries" - requests made by lenders in order to make you a "pre-approved" credit offer - or "administrative inquiries" - requests made by lenders to review your account with them. Requests that are marked as coming from employers are not counted either.

- **Any information not found in your credit report.**

- **Any information that is not proven to be predictive of future credit performance.**

- **Whether or not you are participating in a credit counseling of any kind.**

The Web site also provides free information on actions consumers should take -- or avoid taking -- to improve their FICO scores over time.[7]

Improving Your Score Email This

[6] Available at http://www.myfico.com/myFICO/CreditCentral/ScoringWorks/FICOIgnores.asp.
[7] Accessible at http://www.myfico.com/myFICO/CreditCentral/ScoreConsiders/Tips/AmountsOwedTip.asp

It's important to note that raising your score is a bit like losing weight: It takes time and there is no quick fix. In fact, quick-fix efforts can backfire. The best advice is to manage credit responsibly over time. To see how much money you can save by just following these tips and raising your score, click here.

Payment History Tips

- **Pay your bills on time.**
  Delinquent payments and collections can have a major negative impact on your score.
- **If you have missed payments, get current and stay current.**
  The longer you pay your bills on time, the better your score.
- **Be aware that paying off a collection account will not remove it from your credit report.**
  It will stay on your report for seven years.
- **If you are having trouble making ends meet, contact your creditors or see a legitimate credit counselor.**
  This won't improve your score immediately, but if you can begin to manage your credit and pay on time, your score will get better over time.

Amounts Owed Tips

- **Keep balances low on credit cards and other "revolving credit".**
  High outstanding debt can affect a score.
- **Pay off debt rather than moving it around.**
  The most effective way to improve your score in this area is by paying down your revolving credit. In fact, owing the same amount but having fewer open accounts may lower your score.
- **Don't close unused credit cards as a short-term strategy to raise your score.**
- **Don't open a number of new credit cards that you don't need, just to increase your available credit.**
  This approach could backfire and actually lower score.

Length of Credit History Tips

- **If you have been managing credit for a short time, don't open a lot of new accounts too rapidly.**
  New accounts will lower your average account age, which will have a larger effect on your score if you don't have a lot of other credit information. Also, rapid account buildup can look risky if you are a new credit user.

New Credit Tips

- **Do your rate shopping for a given loan within a focused period of time.**
  FICO® scores distinguish between a search for a single loan and a search for many new credit lines, in part by the length of time over which inquiries occur.
- **Re-establish your credit history if you have had problems.**
  Opening new accounts responsibly and paying them off on time will raise your score in the long term.
- **Note that it's OK to request and check your own credit report.**
  This won't affect your score, as long as you order your credit report directly from the credit reporting agency or through an organization authorized to provide credit reports to consumers.

Types of Credit Use Tips

- **Apply for and open new credit accounts only as needed.**
  Don't open accounts just to have a better credit mix - it probably won't raise your score.
- **Have credit cards - but manage them responsibly.**
  In general, having credit cards and installment loans (and paying timely payments) will raise your score. Someone with no credit cards, for example, tends to be higher risk than someone who has managed credit cards responsibly.
- **Note that closing an account doesn't make it go away.**
  A closed account will still show up on your credit report, and may be considered by the score.

In addition, myFICO.com provides consumers with other free, educational information, including: (1) ways in which credit scores help consumers; (2) the types of information included in consumer reports and what to do if an error in a consumer report is suspected; (3) over 50 different financial calculators to help consumers manage their money; and (4) an extensive section of Frequently Asked Questions[8] regarding credit scoring.

FICO® Scores
What is a FICO score?
How can I improve my FICO score?
What's the most important factor in a Score?
Do insurance companies look at FICO credit risk scores?
What do FICO scores ignore?
What is a good FICO score?
How often does the score change?
How are the FICO scores calculated?
What are the highest and lowest FICO scores?
Why do lenders use FICO scores?
Does everyone have a FICO score?
What is a BEACON score?
Will ordering my FICO® score cause it to drop?
Will my score actually change over time?
Is my score more likely to go up or down?

Fair Isaac has also pioneered new tools to help consumers better understand what influences their scores and how their scores affect lender decisions. Fair Isaac provides consumers with a free interest-rate tool on www.myFICO.com that matches consumer FICO scores with current interest rates currently charged by lenders for 18 different types of mortgage and auto loans.[9] The tool helps consumers quickly understand how getting a better FICO score can translate into more attractive credit terms and significant dollar savings over time.

FICO Scores are Readily Available to Consumers.

Today Fair Isaac provides FICO® scores, directly to consumers through several distribution channels. These scores are always accompanied by key supplementary

[8] Available at http://www.myfico.com/myfico/FAQ.asp.
[9] Accessible at http://www.myfico.com/myfico/CreditCentral/LoanRates.asp.

information that helps the consumer understand and use the score: the consumer's underlying credit report and Fair Isaac's personalized score analysis including the range of possible scores, where the consumer's score falls on that range, what factors contributed most to their particular score and given those factors, examples of steps they could take to improve their score over time. At www.myFICO.com, consumers can get their FICO score calculated from data in their consumer credit report provided by any of the three national credit reporting agencies: Equifax, Experian and TransUnion. For a modest fee, the basic product provides the consumer's FICO score, Fair Isaac's personalized explanation of the score and suggestions for steps the consumer could take to improve it over time, the underlying credit report information from which the score was calculated, and access to the FICO Score Simulator.

Fair Isaac has also worked with the credit reporting agencies so that those credit reporting agencies can also provide FICO scores directly to consumers, accompanied by the underlying credit report and Fair Isaac's personalized explanation and suggestions for improving the score over time. As of today, Equifax and TransUnion both offer FICO Scores and explanation product to consumers via their websites as well.

In addition, Fair Isaac works with a variety of businesses to create new channels that consumers can use to access FICO score-based consumer products and information. These businesses include some of the nation's leading financial service providers, as well as financial management solution providers such as Quicken.com, and non-profit credit counseling organizations such as Springboard and Consumer Credit Counseling Service of Santa Clara and Ventura Counties.

Alerting the Public to FICO Score Availability. Even though Fair Isaac has worked diligently to let consumers know what information about FICO scores is available, the biggest challenge remains getting the word out. Since June, 2000, Fair Isaac has welcomed and encouraged media coverage on the importance to consumers of credit scores and Fair Isaac's efforts to empower and educate consumers with scores and related information. The media's response has been extremely helpful to consumers and includes articles and broadcast coverage in hundreds of outlets including *The Wall Street Journal*, *The New York Times*, *USA TODAY*, *Newsweek*, *NBC Network News*, *National Public Radio*, and *The Today Show*.

Other examples of consumer education and outreach include:

- Conducted a number of credit scoring presentations in conjunction with the Greater Washington Urban League (GWUL). We are also assisting GWUL with a new first-time homeownership program.
- Conducted educational seminars for the Association of Independent Credit Counseling Agencies (AICCCA), AARP, and several other institutions.
- Assisted the University of Wisconsin Extension with implementation of a home buying seminar and use of the FICO Score Estimator as part of the course.

- Partnered with Fannie Mae and Rushcard to conduct a credit and home-buying educational event at Howard University.

In a further effort to increase public awareness, in May 2003, Fair Isaac hosted numerous consumer advocacy organizations for an intensive discussion on credit scoring and the best ways to reach consumers, especially underserved consumer groups, with credit scoring information that can help them improve their overall credit health. Participants included representatives from such organizations as Consumer Action, La Raza, and Operation Hope. We continue to have discussions with several of these groups on an on-going basis.

* * *

Fair Isaac appreciates the opportunity to comment on this important matter. If you have any questions concerning these comments, or if we may otherwise be of assistance in connection with this matter, please do not hesitate to contact me, at (612) 758-5424.

Sincerely,

Steven S. Hoge
Director-Scoring Legal Affairs